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IN THE

Supreme Court of the United States

October Term, 1974

No. 73-1701

UNITED STATES OF AMERICA,

Appellant,

v.

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC., *et al.*,

Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLUMBIA

BRIEF FOR FIDELITY FUND, INC. AND THE CROSBY CORPORATION

Question Presented

The Investment Company Act of 1940 ("the 1940 Act") establishes a system of fixed prices for the sale of mutual fund shares (§ 22(d)), and sanctions the right of the funds to restrict the transferability and negotiability of their shares, absent SEC disapproval (§ 22(f)). The statute also clothes the Securities and Exchange Commission ("the SEC") with broad supervisory and regulatory power over industry activity in general and the pricing and distribution of shares in particular; accordingly, for the past 35 years the SEC has been acting as the surrogate of Congress in monitoring and controlling industry operations.

In appearances before Congressional committees and at SEC hearings the Department of Justice has over many years repeatedly but unsuccessfully contended for the abolition of all restraints on competition in the pricing and distribution of fund shares in both primary and secondary markets, whether by outright repeal of § 22(d) or by the exercise of SEC authority under § 22(f), or by resort to the SEC's pervasive regulatory power under the 1940 Act. Frustrated by the futile pursuit of this sweeping objective, the Department's Antitrust Division now seeks accomplishment of the same design by an antitrust injunction. In this effort the appellant challenges under the antitrust laws long-established contractual restrictions on the pricing, transferability and negotiability of shares, well known to the SEC, but not limited nor proscribed by that agency.

After probable jurisdiction of this appeal had been noted, the SEC published on November 9, 1974 a report entitled "Mutual Fund Distribution and Section 22(d) of the Investment Company Act of 1940" ("the 1974 Report"). This intervening event brings sharply into focus the basic conflict in this case: the jurisdictional clash between the Department of Justice, seeking the immediate nullification and prohibition of long-standing industry practices through application of the Sherman Act, and the SEC, recommending that these same practices be continued but gradually modified on an experimental basis under the 1940 Act by administrative action and, where necessary, Congressional amendment. The 1974 Report proposes a series of specific concrete steps by appellee National Association of Securities Dealers ("NASD"), by Congress and by the SEC itself, regarding the very subject matter of this litigation, namely, price competition in the retailing of mutual fund shares in secondary markets. Therefore, as we believe, the fundamental question presented is:

> Does the existence and exercise by the SEC of its Congressionally delegated power to supervise and regulate the pricing and marketing of mutual fund shares exempt the alleged restraints on competition from application of the Sherman Act?

The questions presented to the court below and those stated in appellant's brief in this Court are all subsumed in this basic issue of antitrust immunity for closely regulated, supervised and approved conduct.

Statutes Involved

Sections 22(d) and 22(f) (15 U.S.C. §§ 80a-22(d) and (f)) of the 1940 Act provide:

> "(d) No registered investment company shall sell any redeemable security issued by it to any person except either to or through a principal underwriter for distribution or at a current public offering price described in the prospectus, and, if such class of security is being currently offered to the public by or through an underwriter, no principal underwriter of such security and no dealer shall sell any such security to any person except a dealer, a principal underwriter, or the issuer, except at a current public offering price described in the prospectus. * * *
>
> "(f) No registered open-end company shall restrict the transferability or negotiability of any security of which it is the issuer except in conformity with the statements with respect thereto contained in its registration statement nor in contravention of such rules and regulations as the Commission may prescribe in the interests of the holders of all of the outstanding securities of such investment company."

Proceedings and Opinion Below

After issue had been joined, the appellees moved to dismiss the Complaint on the ground that the practices challenged were as a matter of law immune from antitrust attack by virtue of the 1940 Act. The appellant responded with an affidavit and thirty exhibits to support the Complaint. Upon a finding that the 1940 Act, either by express provision or necessary implication, conferred antitrust immunity for the conduct alleged in the Complaint, even as amplified by the appellant's affidavit and exhibits, the Complaint was dismissed on the merits.[1] The dismissal rested, not upon resolution of issues of fact, but purely on principles of antitrust immunity as applied to the facts presented.

Statement of the Case

The filing of the 1974 Report with Congress casts new light on the fundamental issue presented. Before discussing the Report's recommendations, however, we should briefly describe the mutual fund marketing structure established by Congress and the erosion of that structure which appellant would achieve through the injunctive relief it seeks.

The Marketing of Shares

Appellee Fidelity Fund, Inc. ("Fidelity") is an "open-end management investment company" as defined in the

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[1] In addition to dismissing the instant case, the District Court also dismissed two private treble damage class actions alleging similar antitrust violations; the court also stayed proceedings in more than 40 other similar treble damage class actions which had been transferred to its jurisdiction by the Judicial Panel on Multidistrict Litigation. Appeals from the dismissal of the private class actions have been docketed in the Court of Appeals for the District of Columbia Circuit, and are now stayed pending disposition of this appeal.

1940 Act,[2] commonly known as a mutual fund. As required by the statute,[3] Fidelity sells its shares under a written agreement with its principal underwriter, appellee The Crosby Corporation ("Crosby"), whereby Crosby acts as sole distributor of Fidelity shares. Crosby, in turn, enters into agreements in writing with retail dealers (some of whom are named as appellees) to sell Fidelity shares to the public. This fund-underwriter-dealer chain is known as the "primary distribution system" for the sale of mutual fund shares.

Fidelity's only assets are shares in other corporations. The daily market value of these shares, plus cash on hand, less the fund's current liabilities, constitutes the "net asset value" of Fidelity's shares. Fidelity shares are issued continuously and sold at net asset value, plus a commission divided between Fidelity's principal underwriter and the dealers, known as the "sales load," ranging from 1% to 8.5% of the purchase price, depending upon volume. This "public offering price" is the price which must be charged the purchasing investor as required by § 22(d) of the 1940 Act. Fidelity also guarantees to redeem its shares upon demand at net asset value (Complaint, par. 9; App. p. 7).[4]

The funds are obliged to file a registration statement with the SEC that must be kept current with the continual issuance of fund shares. It is undisputed that the Crosby-dealer contracts, containing the restrictions on competition here questioned, have been regularly filed with and disclosed to the SEC. Indeed, these restrictions have remained substantially unchanged before and since Fidelity's

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[2] 15 U.S.C. §§ 80a-3, 4 and 5.

[3] 15 U.S.C. § 80a-12(b).

[4] Citations denoted "App." are to the printed Appendix on Appeal.

first filings shortly after passage of the 1940 Act (Loring affidavit, par. 7; App. p. 156).[5]

Alleged Antitrust Violations

The agreement between Crosby and dealers in Fidelity shares provides, and has substantially provided since 1940, as follows:

> "You [the dealer] agree not to purchase as principal, or to participate as broker in the purchase of, any Fund shares except through or from us or from investors, and to pay a price not lower than the net asset value then quoted by or for the appropriate Fund. You further agree not to sell as principal, or to participate as broker in the sale of, any Fund shares except at a price to the purchaser equal to the applicable public offering price (determined as set forth in the then currently effective applicable Fund Prospectus), unless such sale is to the Fund or to us, provided nothing in this paragraph shall prevent you from selling to us for the account of an investor any shares of the appropriate Fund at the net asset value price currently quoted by or for the Fund and charging the investor a fair commission for handling the transaction.
>
> "You agree that you will not withhold placing a customer's order in such manner as to profit your-

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[5] There is no dispute as to the nature of the statutory mutual fund marketing structure and its effects on price competition. As this Court has described the market that "the [1940] Act creates and regulates" in *U.S.* v. *Cartwright,* 411 U.S. 546, 549 (1973):

> "Private trading in mutual fund shares is virtually nonexistent. Thus, at any given time, under the statutory scheme created by the Investment Company Act, shares of any open-end mutual fund with a sales load are being sold at two distinct prices. Initial purchases by the public are made from the fund, at the 'asked' price, which includes the load. But shareholders 'sell' their shares back to the fund at the statutorily defined redemption or bid price."

> self as a result of such withholding. You further agree that you will not purchase shares, other than for investment, except for the purpose of covering purchase orders, already received, and then only at the public offering price at which such orders were taken less the dealer discount allowed hereunder. We will not accept a conditional order for shares of the Fund."[6]

The Complaint alleges that these provisions prohibit Fidelity's contract dealers from acting as brokers in sales transactions at less than the public offering price, thereby improperly restricting the development of a brokerage market in previously issued shares (a "secondary brokerage market") (Complaint, pars. 23(a), 24(a), 29, 30(a); App. pp. 10, 11, 12). Were such restrictions enjoined, it is claimed, a mutual fund purchaser could acquire shares through a broker who could obtain them from a fund shareholder rather than from the fund underwriter, charging only a brokerage commission in place of the full sales load (Appellant's Brief, p. 10). This, it is asserted, would engender retail price competition.[7]

It should be observed here that the purchase price of mutual fund shares is the result of (1) free and open competition in the securities markets where the portfolios of each fund are traded daily; and (2) competition among the funds in the investment expertise each has to offer prospective investors. In other words, the net asset value of fund shares, which comprises more than 90% of the public offer-

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[6] Fidelity Answer, Exh. A; App. pp. 36-37. The defense of antitrust immunity was also raised in Fidelity's Answer. Pars. 25, 27; App. p. 32.

[7] In other words, the contract dealer, required by his Crosby contract to sell Fidelity shares as part of the primary distribution system, is to be set free to act as a freelance "broker" in the sale of already issued shares from a Fidelity shareholder to a new investor, in competition with Crosby, Fidelity's underwriter, and with Fidelity itself—the issuer of the shares.

ing price and also constitutes the entire redemption price, is determined by unrestrained competition in the securities markets. Hence, it is conceded that only the load or sales commission can be affected by unrestricted sales in secondary markets (Appellant's Brief, p. 9), and it is the sales load that is the target of this suit. The sales loads vary from fund to fund, and are not fixed by agreement among the funds; and no such agreement is alleged in the Complaint. Nevertheless, the appellant seeks through injunctive relief to open up the sales load to competitive forces in secondary markets and it pursues this goal despite the deliberate decision of Congress that the sales loads be continued, subject only to SEC-NASD regulation limiting them to "reasonable" amounts.[8]

The Complaint also alleges that the dealer agreements require dealers to obtain shares for resale to customers exclusively from the fund underwriter (Complaint, pars. 23(b), 29; App. pp. 10-11, 12), whereas, it is claimed, if dealers were permitted to purchase shares directly from fund shareholders, they would find it profitable to pay somewhat above the net asset value that the selling shareholder would otherwise receive on redemption (Appellant's Brief, p. 10). The dealer could then resell at the full public offering price as required by § 22(d), but would not be required, as he is now when he sells shares obtained from the fund underwriter, to share the sales load with the underwriter. Manifestly, public benefit in a secondary dealer market would be minimal because the sales load would still be maintained.

[8] 15 U.S.C. § 80a-22(b)(1).

SEC Consideration of and Recommendations Regarding the Same Restraints on Competition in Secondary Markets Here Sought to be Removed by Antitrust Injunction

The 1974 Report deals explicitly and exhaustively with retail price competition in secondary markets. It presents to Congress (at whose request it is made) recommendations regarding the extent to which the SEC considers this competition to be presently in the interests of the investing public, together with such safeguards as are deemed necessary to insure protection for the primary distribution system.

Five features of the Report are of primary significance: First, the SEC recommends, whether by Congressional legislation, Commission rule, or industry (NASD) self-regulation, the gradual elimination of existing contractual restrictions on a secondary *brokerage* market only, and only insofar as this is deemed presently warranted economically and in the best interests of the industry, investors and general public. Second, the SEC also recommends the indefinite postponement of similar action regarding competition in a secondary *dealer* market as untimely, unwise and economically unpredictable. Third, the Report, and its recommendations for proposed action or inaction, are an exertion of unquestioned SEC power, fully authorized by the 1940 Act and indeed conceded by the appellant. Fourth, the Report is the result of careful expert investigation made at the request of Congress. Fifth, the SEC addresses itself specifically to secondary broker and dealer market competition and the regulation of the sales load—*the identical subject matter of this antitrust action.*

Whatever disagreement there may be, whether among the appellees, between the SEC and the Department of

Justice or elsewhere, as to the soundness and efficacy of the Report's recommendations, there can be no doubt that it is legislative and administrative action, not antitrust litigation, that Congress has been and is now looking to as the solution to the problems of competition, if there be any, in the marketing of mutual fund shares.

The development of the 1974 Report exemplifies the far-reaching SEC jurisdiction in this area. In 1962, the SEC, pursuant to its authority under the 1940 Act, sent to Congress a wide-ranging study of the mutual fund industry[9] (the *Wharton Study*), including the question of sales loads and the treatment of investors in purchasing and selling mutual fund shares. This report was followed by a further exhaustive study of the securities markets, released and presented to Congress in 1963[10] (the *Special Study*) which again contains a probing analysis of sales loads and their impact on investors. An additional study of the mutual fund industry was submitted to Congress in 1966[11] (the *Public Policy Report*). In 1967 the SEC submitted its recommendations for remedial legislation to Congress, and lengthy hearings were held in both the Senate and House that year and in the years next following regarding suggested legislative changes in the mutual

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[9] Wharton School of Finance and Commerce, *A Study of Mutual Funds*, H. Rep. No. 2274, 87th Cong., 2d Sess. (1962) (*Wharton Study*).

[10] *Report of Special Study of Securities Markets of the Securities and Exchange Commission*, H. Doc. No. 95, 88th Cong., 1st Sess. (1963) (*Special Study*).

[11] *Report of the Securities and Exchange Commission on the Public Policy Implications of Investment Company Growth*, H. Rep. No. 2337, 89th Cong., 2d Sess. (1966) (*Public Policy Report*).

fund marketing structure.[12] Because § 22(d) was considered by all, including the Department of Justice, to be the bastion of the price maintenance system, most attention was directed to the advisability of repeal or modification of that section.

However, although Congress in 1970 amended the 1940 Act in other respects, it neither repealed nor amended § 22(d). Instead, the SEC was requested to study still further the possible economic impact of a repeal of that section.[13] In response, the SEC first issued in 1972 a preliminary report discussing the many complex factors (pro and con) to be taken into account regarding possible repeal of § 22(d).[14] The SEC then held extensive hearings, in which the Department of Justice prominently participated.[15] Thus, the 1974 Report is actually the culmination of more than ten years of administrative and legislative study of the possible effects upon the mutual fund marketing system

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[12] Hearings on S. 1659 before the Senate Comm. on Banking & Currency, 90th Cong., 1st Sess. (1967) (*1967 Senate Hearings*); Hearings on H.R. 9510 & 9511 before The Subcomm. on Commerce & Finance of the House Comm. on Interstate & Foreign Commerce, 90th Cong., 1st Sess. (1967) (*1967 House Hearings*); Hearings on S. 34 & S. 296 before The Senate Comm. on Banking & Currency, 91st Cong., 1st Sess. (1969) (*1969 Senate Hearings*); Hearings before The Subcomm. on Securities of the Senate Comm. on Banking & Currency, 91st Cong., 1st Sess. (1969).

[13] S. Rep. No. 91-184, 91st Cong., 1st Sess. (1970).

[14] *Report of the Staff of the SEC on the Potential Impact of a Repeal of Section 22(d) of the Investment Company Act of 1940* (November, 1972) (*1972 Staff Study*).

[15] *In The Matter of Mutual Fund Distribution and the Potential Impact of a Repeal of Section 22(d) of the Investment Company Act of 1940*, SEC File No. 4-164 (1973) (*1973 SEC Hearings*).

of permissive competition.[16] The present peremptory incursion of antitrust enforcement into this ongoing deliberative administrative and legislative process is a disruptive intrusion; and it ignores the legislative history we have described, which manifests the clear intent of Congress that the SEC have exclusive supervisory and regulatory jurisdiction over the pricing and distribution of mutual fund shares, subject only to continuous Congressional control.

The 1974 Report, addressing itself to the *identical* industry practices here attacked, now recommends:

As to Competition in a Secondary Brokerage Market

After detailed discussion and analysis, the Report

> ". . . recommends that the Commission now act in this area and request the NASD to amend its Rules of Fair Practice to prohibit restrictions against a secondary brokered market. We also recommend that, if necessary the Commission promulgate a rule under Section 22(f) to prevent funds from accomplishing the result presently obtained in sales agreements by restricting the transferability of their shares. However, steps should be taken to prevent a secondary brokered market from having an adverse impact on the primary distribution system." (p. 109)

As to Competition in a Secondary Dealer Market

The Report expresses the view that the time and climate are not right for introduction of competition in a secondary dealer market. In this connection it states:

> "Development of a secondary brokered market would depend on demand for fund shares and the

[16] As put by SEC Chairman Garrett in his letter transmitting the 1974 Report to Congress (page ii): "The subject of mutual fund distribution has been an important part of a series of reports and studies made for and by the Commission over more than a decade."

compensation available, which would be competitively determined . . . Such a limited secondary brokered market would not disrupt the primary distribution system, and *it would introduce possible price variations and provide insight into whether a secondary dealer market could function effectively.*" (p. 109)[17]

As to the Regulation of Sales Loads

The Report reviews the Congressional decision in 1970 refusing to impose a legislative ceiling on sales loads, instead giving the NASD regulatory authority over the amount of the load. It then recommends that the SEC not oppose a pending NASD rule on maximum sales loads, basing its decision on the fact that the proposed NASD rule is the result of an exhaustive study of sales loads undertaken by the NASD. (pp. 122-127)

As to Broadened Price Competition in the Future

The Report expresses the hope that, stimulated by the SEC and the NASD, the funds may voluntarily adopt price variations in the primary distribution system through applications to the SEC for exemptions (under § 6(c) of the 1940 Act) from the prices mandated by § 22(d). However, it is speculated that the industry might "unduly resist implementing the price variations which would be necessary first steps toward retail price competition . . . ." In that eventuality, the Report recommends "that the Commission ask Congress to amend Section 22(d) to provide the Commission with adequate authority to *require* price variations such as those described." This authority, the Report suggests, "could be exercised upon a finding that the industry had failed to move toward price compe-

[17] Unless otherwise indicated, italics in quotations throughout this brief are supplied.

tition voluntarily, and that such failure was not justified by the likelihood of serious adverse consequences for the fund distribution system" (p. 115). However, even in making this recommendation the Report cautions: "There is, of course, a necessity to avoid disruption of the fund distribution system" (Id.).

As the ultimate desideratum, the Report contemplates a time when "it should be feasible to eliminate retail price maintenance with respect to *all* mutual fund retailers; the secondary market would not be prohibited and contract as well as non-contract dealers would compete with each other" (p. 119).

The need is again emphasized, however, that "fund underwriters and contract dealers be protected from unfair competition on the part of secondary market-makers." These anti-competitive safeguards are enumerated in detail (pp. 119-121).

The Conflict Between the SEC and the Antitrust Division

Obviously, the SEC and the Department of Justice are now on a collision course regarding their views as to the need for price competition in the marketing of mutual fund shares. The conflict is sharply drawn in the 1974 Report, which notes that

> "the Department of Justice urged *an immediate end to retail price maintenance,* either by legislative or administrative action." (Report, p. 9)

Conversely,

> "The Commission is committed to the general proposition that the securities industry should operate—to the extent possible—in an environment of free and vigorous price competition. *In the mutual fund industry, however, the Division does not be-*

> *lieve that it would be possible to move quickly to retail price competition without seriously disrupting the distribution of fund shares.* In view of the open-end self-liquidating nature of mutual funds, such disruption should be avoided, if at all possible, and certainly minimized." (Report, p. 10)

The same policy conflict flares in this litigation. The Department would nullify and prohibit all contractual restraints on competition in secondary dealer and brokerage markets as violations of the antitrust laws, regardless of the economic consequences to the primary distribution system established and maintained after Congressional deliberation and command. The SEC, on the other hand, while recommending the gradual lifting of contractual restraints upon a secondary brokerage market, regards as untimely and inadvisable the elimination of such restraints on a secondary dealer market. And even in advising a degree of permissive secondary brokerage market competition, the SEC recognizes the possible unknown and presently unknowable adverse effects on the primary distribution system and recommends advance adoption of specific safeguards against these consequences.

In the event that the sweeping injunction here sought by the Department of Justice were granted, it is quite impossible to perceive how the recommendations of the 1974 Report could legitimately be promoted or adopted by the SEC. For certainly, a decree enjoining as violations of the Sherman Act the alleged existing restraints on competition in secondary dealer and broker markets would preclude any SEC temporizing with those restraints and prohibit

their continuance even in the modified form recommended in the 1974 Report.[18] Indeed, those recommendations themselves might well become violations of the antitrust injunction.

The appellant does not gainsay the jurisdiction of the SEC over the subject matter of the 1974 Report, nor its power to adopt and administer, subject to Congressional approval, the recommendations contained therein. The only question then, is whether that jurisdiction is exclusively the SEC's or concurrently the Justice Department's. Common sense leads to the conclusion that these two conflicting regimes cannot govern simultaneously in the same field, and that the mutual fund industry could not continue to prosper under this Janus-faced supervision and control.

Fortunately, Congress has provided the solution. In the 1940 Act it conferred upon the SEC a regulatory power over the industry, and particularly over the pricing of mutual fund shares, so pervasive as to raise the inevitable presumption of a Congressional exemption of this area from the antitrust laws. This is demonstrated by the provisions and the legislative and administrative history of the 1940 Act.

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[18] For example, the Complaint seeks an order enjoining the appellees from imposing "any limitation" upon the dealer's right to act as broker or as to whom he may sell shares or from whom he may buy them (Complaint, par. 3, prayer for relief; App. p. 18). Yet the Report recommends *against* elimination of contractual restrictions on a dealer market, and proposes that dealers need not attempt to match buy and sell orders as brokers unless such orders are received within the same 24 hour period. These recommendations propose market "limitations" which the appellant would eliminate entirely. In addition, in order to protect the primary distribution system, the Report recommends permitting the imposition of a transfer fee in secondary market transactions to compensate the underwriter for the loss of the portion of the sales load he would otherwise receive (Report, p. 106).

Mutual Fund Marketing Conditions Before the 1940 Act

Prior to 1940, mutual funds were sold in a chaotic marketing environment. Funds distributed their shares through underwriters as they do today. For example, the Fidelity-dealer sales agreements existing before the 1940 Act contained restrictions nearly identical to those now being challenged for the first time by the appellant many years later. As found by a four-year SEC study of the investment company industry submitted to Congress at its request in 1939,[19] there was retail price competition engendered by a "bootleg market" in mutual fund shares maintained by freelance dealers not bound by contract to any fund or underwriter, and hence not limited by the restrictions imposed on contract dealers. As a consequence, they bought from shareholders at "a little more than the published redemption price" and sold at a "little less than the published sale price."[20]

The bootleg market thus described is of importance here in two principal respects: First, its dealers were trading shares in a secondary market precisely as the appellant urges the antitrust courts to require today, *i.e.*, buying from investors at above the redemption price (secondary dealer activity) and selling at less than the public offering price (similar to secondary broker activity). Second, contract dealers, if circumstances required, were free to sell

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[19] Report of the SEC, *Investment Trusts and Investment Companies, Part Three, Abuses and Deficiencies in the Organization and Operation of Investment Companies*, H.R. Doc. No. 276, 76th Cong., 1st Sess., p. 865 (1939) *(Investment Trust Study)*.

[20] *Id.*

fund shares to non-contract dealers. As the *Investment Trust Study* put it:

> "A certain amount of protection was received by such [bootleg] operators through their ability to obtain shares from the legitimate distributors if these dealers were short." (p. 865)

The bootleg market seriously undermined the contractual primary distribution system: Bootleg dealers were undercutting contract dealers to such an extent that the latter were forced to free themselves from the obligation to maintain the full sales price by cancelling their agreements with their underwriters. As one informed commentator described the situation:

> "Authorized dealers, bound by contract to offer shares only at the public offering price described in the prospectus, were unable to meet the lower prices of their non-contract competitors by reducing sales charges. This difficulty apparently led to the cancellation of many selling agreements and resulted in increasing numbers of dealers leaving the field. It has been contended that, if the 'bootleg' market had been permitted to continue, contractual distribution systems would not have been able to survive. . . ." (Footnote omitted.)[21]

The bootleg market endangered not only the contractual distribution system, but also the viability of the funds themselves. Since the funds had to redeem shares continually, fresh cash from the purchase of newly issued shares was necessary to meet redemptions; otherwise the funds would be forced to liquidate securities, sometimes at

[21] Greene, *The Uniform Offering Price of Mutual Fund Shares Under the Investment Company Act of 1940*, 37 U. Det. L.J. 369, 371-372 (1960). Mr. Greene is a former Assistant Director of the SEC's Division of Corporate Regulation.

a loss, in order to meet redemptions. The major source of cash to honor redemptions was the sale of fresh shares through the primary distribution system.[22] The bootleg market threatened to curtail this needed cash flow.[23]

The price-cutting secondary market in fund shares, thus depicted and presented to Congress by the SEC in 1940, constituted a grave threat to the industry's continued viability, which the funds attempted to counteract with private contractual measures which either confined sales to the primary distribution system or required that all sales be made at the published selling price.[24]

Congressional Response through the 1940 Act

Sections 22(d) and 22(f) of the 1940 Act, as ultimately enacted, were the product of SEC and industry collaboration, intended to counteract the ruinous competition of this secondary bootleg market. Whether the bootleg market was in fact a menace is not important. What is important is that it was so regarded in 1940, and the only relevant question is: What did Congress intend be done about it and by whom.

The Congressional response took several forms. In § 22(d), Congress required *all* dealers (not merely those under contract to the funds) to maintain the public offering price in sales to the public. This eliminated the price competition among dealers existing in 1940 and served to pro-

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[22] *Public Policy Report* at 202; see also *Special Study*, Part 2, at 95-97.

[23] Greene, *op. cit. supra*, at 372.

[24] *Investment Trust Study* at 860-871; statements of SEC Chairman Manuel E. Cohen before the House and Senate Committees considering amendments to the 1940 Act in *1967 House Hearings*, 59; *1967 Senate Hearings*, 151.

tect the primary distribution system from the incursions of the bootleg market.

In § 22(f), Congress recognized the right of mutual funds, as added protection against secondary market price-cutting, to restrict transferability of their shares while at the same time granting the SEC power to control these restrictions by rule or regulation. And throughout the Act the SEC was given broad, pervasive regulatory power to deal with all aspects of the mutual fund industry, particularly problems arising from the pricing and distribution of fund shares.

Since Congress in one instance mandates (§ 22(d)) and in the other sanctions (§ 22(f)) industry measures designed to prohibit or limit the very same secondary market competition which the appellant would require by judicial decree, it follows that Congress has by necessary implication immunized the pricing and distribution of mutual fund shares from antitrust law application. As the District Court held:

> ". . . the creation and maintenance of a free and open secondary market would be totally inconsistent with and might destroy the primary marketing system that is created by the 1940 Act." (Opinion below, App. p. 345.)

Summary of Argument

The statutory plan for the sale and distribution of mutual fund shares established by Congress in the 1940 Act, and the implementation of that plan by the SEC as its authorized administrator, are incompatible with the imposition of civil or criminal antitrust liability under the Sherman Act for long-continued practices which are neither

contrary to the 1940 Act nor against SEC regulation under that statute.

Section 22(d) indisputably immunizes price fixing in the sale of shares in the primary distribution system; and it necessarily implies Congressional opposition to price competition in a secondary market endangering the integrity of that system.

In furtherance of this Congressional policy, Congress in § 22(f) recognized and gave its sanction to the right of mutual funds to check secondary market competition through dealer agreements reported to the SEC and not contravening SEC rule or regulation.

In accordance with this statutory structure, it has from the very beginning been the responsibility and function of the SEC to oversee industry conditions, to implement the 1940 Act, and to accomplish itself or recommend for Congressional approval or disapproval proposals for changes in the non-competitive system originated and maintained by the 1940 Act.

This Congress-SEC collaboration is presently in progress, as it has been in the past, regarding the advisability of permitting competition in the secondary dealer and brokerage markets. The precipitous intrusion of this litigation by the Department of Justice into the legislative-administrative process would inevitably result in a confrontation of conflicting economic philosophies and a clash of incompatible regimes, causing disruptive havoc in a well ordered and carefully regulated industry.

ARGUMENT

The Legislative and Administrative System Established by Congress for the Sale and Distribution of Mutual Fund Shares Precludes Antitrust Attack on the Alleged Restrictions on a Secondary Market.

In 1940, Congress established a mutual fund distribution system and placed it under the supervision and control of the SEC and NASD. Thus, regulation of sales loads—the target of appellant here—is vested in the NASD under § 22(b) of the 1940 Act. Section 22(c) empowers the SEC to approve or disapprove such NASD rules.[25] In § 22(d), Congress fixed the prices at which dealers must sell shares, and in § 22(f) it sanctioned restrictions on transferability and negotiability.

In addition to § 22, the SEC is granted broad powers by other sections of the 1940 Act. Section 6(c) empowers the SEC to "exempt any person, security, or transaction . . . from any provision" of the Act "if and to the extent that such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions" of the Act.[26] 15 U.S.C. § 80a-6(c). And § 38 clothes the SEC with "authority from time to time to make, issue, amend, and rescind such rules and regulations and such orders as are necessary or appropriate

[25] As noted above, the SEC-NASD rule-making power over sales loads is one of the subjects of the 1974 Report, and administrative action is presently being taken.

[26] The Antitrust Division took the position before the SEC that the SEC's powers under § 6(c) were so pervasive as to enable the SEC to nullify the effects of § 22(d) without even waiting for repeal (1974 Report at 70).

to the exercise of the powers conferred upon the Commission elsewhere" in the Act. 15 U.S.C. § 80a-38.[27]

Indeed, as the letter transmitting the 1974 Report to Congress states, "No issuer of securities is subject to more detailed regulation than a mutual fund." This "detailed regulation," including strict control over the marketing and distribution of mutual fund shares, is so pervasive as to raise the presumption of an exemption from the antitrust laws. See, *e.g.*, *Hughes Tool Company* v. *Trans World Airlines*, 409 U.S. 363 (1973); *Pan American World Airways* v. *United States*, 371 U.S. 296 (1963); *Baum* v. *Investors Diversified Services, Inc.*, 286 F. Supp. 914 (N.D. Ill. 1968), *aff'd* 409 F.2d 872 (7th Cir. 1969).

The intent of Congress that the fund distribution system be maintained as it existed in 1940, subject only to the control of the SEC, finds greatest support in §§ 22(f) and 22(d) of the 1940 Act.

A. By Section 22(f) Congress Authorized the Alleged Secondary Market Restrictions Subject Only to SEC Disapproval.

Section 22(f) provides that restrictions on transferability and negotiability of shares are valid if disclosed to the SEC in the fund's registration statement and not in contravention of any SEC rule or regulation. The enactment of § 22(f), despite Congressional awareness of existing contractual inhibitions on secondary market competition,[28] evidences the intention that these limitations not

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[27] The SEC has in fact exercised its broad rule-making powers in connection with the pricing and distribution of mutual fund shares. See, *e.g.*, Investment Company Act Rules 22c-1, 22d-1 and 22d-2, 17 C.F.R. §§ 270.22c-1, 22d-1 and 22d-2.

[28] In fact, sales agreements contained such restrictions even before passage of the 1940 Act. *Investment Trust Study* at 860-71.

only *not* be eliminated, but that they be continued subject only to SEC regulation.

When first proposed in the SEC draft bill, the section, then numbered 22(d)(2), gave the SEC power to

> "*prohibit* . . . restrictions upon the transferability and negotiability of any redeemable security of which any registered investment company is the issuer."

In testimony in connection with this proposed section, David Schenker, Chief Counsel to the SEC, explained that the existing private restrictions on transferability to which the draft section referred were directed against the secondary "bootleg" market. As Mr. Schenker testified,

> "Now coming to subparagraph (2) of (d) [now § 22(f)], it just says that the Commission shall have the right to make rules and regulations with respect to any restrictions upon the transferability or negotiability of any redeemable security of which any registered investment company is the issuer.
>
> "There are some companies that have a provision in their certificates to the effect that you cannot sell the certificate to anybody else, and the only way you can sell it is . . . back to the company. That is a technical problem. *It presents a whole problem which they call the bootleg market.*"[29]

Confronted with a secondary market threat, on the one hand, and, on the other, the private restrictions designed to combat that threat, the SEC and the industry in redrafting § 22, and Congress in passing the section, had several choices: (1) the restrictions could have been abolished outright; (2) the statute need not have dealt with the restrictions at all, leaving them vulnerable to the

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[29] Hearings on S. 3580 before Subcomm. of the Senate Comm. on Banking & Currency, 76th Cong., 3d Sess. at 292 (1940).

antitrust laws; (3) Congress could have provided that no restriction should be valid unless specifically approved in advance by SEC rule, thereby establishing *a priori* standards of validity; or (4) § 22(d)(2) could have been enacted as originally introduced, giving the SEC merely power to prohibit all these restrictions, but providing nothing regarding their validity.

Congress adopted none of these alternatives. In § 22(f), it established SEC control, but with the important qualification that a restriction was to be valid if disclosed in a fund's registration statement, unless "in contravention of such rules and regulations as the Commission may prescribe." Congress thus acknowledged the funds' right to continue their existing contractual restrictions on competition, subject only to SEC contravening rule or regulation. As the Court below held, in enacting § 22(f),

> "Congress sanctioned such restrictions with full knowledge of their effect upon a secondary market which existed at the time and in full recognition of the antitrust implications." (App., p. 354)

Appellant searches in vain for any other or different meaning in § 22(f). Directly contrary to the legislative development of § 22(f), appellant distorts its provisions to require that *before* a restriction may be valid it must conform to a *pre-existing* SEC rule or regulation specifically validating it; and since admittedly there is no such rule or regulation, none of the restrictions here involved has validity (Appellant's Brief, p. 44). However, the language and legislative history of the section just recounted establish a directly contrary intention: ***the restrictions are valid unless an SEC rule or regulation invalidates them.***

It is also contended that the restrictions permitted by § 22(f) are those imposed directly by funds—not, as here alleged, by underwriters in agreements with dealers (Appellant's Brief, p. 43). But this ignores the statutory requirement that a fund must use an underwriter to distribute its shares.[30] Additionally the agreements between fund and underwriter require fund approval of the dealer agreements covering sales to the public, to be evidenced by the filing of the dealer agreements by the fund with the SEC.[31] In reality, therefore, restrictions imposed on transferability and negotiability of fund shares originate with the fund.

Indeed, the 1974 Report recognizes that § 22(f) is meant to cover limitations on transferability such as those under attack here. In discussing the abolition of contractual restrictions on a secondary brokerage market, the Report notes:

> "In addition, if it appeared that funds were attempting to defeat the intent of such an NASD rule [prohibiting brokerage restrictions] by restricting transferability of their shares in a secondary brokered market, we would recommend that the Commission propose a rule under Section 22(f) of the Act to prohibit such restrictions."[32]

[30] 15 U.S.C. § 80a-12(b).

[31] In point of fact, the SEC instructions for Form N8B-1, the Registration Statement filed by a fund pursuant to § 8 of the 1940 Act, require attachment of "all agreements between principal underwriters and dealers," and the instructions for Form S-5 filed pursuant to the Securities Act of 1933 in connection with current distribution of fund shares require the same submission.

[32] 1974 Report at 105; See also *Proposed Amendments to the Rules of Fair Practice of the NASD*, 9 SEC 38, 44-45 (1941), where the SEC noted that an NASD rule requiring dealers to become record owners of shares they redeem was a "restriction on transferability," even though the rule did not affect the manner of transferability but only the dealers' conduct, similar to the restrictions challenged in this case.

It should be noted that, prior to this action, the Department of Justice recognized the existence of that power in the SEC under § 22(f). In referring to the suggestion made in the *1972 Staff Study* that, even if § 22(d) were repealed, captive funds would be able to forestall a secondary market by making it hard for dealers to redeem shares, thereby creating a risk that it would be difficult to dispose of shares not obtained through the fund, the Justice Department stated:

> "However, the Commission could eliminate such difficulties, if they arise, by promulgating regulations prohibiting unreasonable restrictions on transferability pursuant to § 22(f) of the Investment Company Act."[33]

This concession of SEC power under § 22(f) was repeated by Mr. Daniel Hunter, of counsel to the appellant below and on this appeal, in testimony before the SEC on the impact of the possible repeal of § 22(d).[34] Moreover, as thus construed by the appellant, § 22(f) clothes the SEC with such plenary power as would enable it to abolish or continue these restrictions in its discretion, even if § 22(d) were repealed.

Finally, appellant errs most conspicuously in asserting that appellees rely on the SEC's "administrative silence" regarding these restrictions (Appellant's Brief, p. 50). The SEC has been anything but silent. The discussion of these restrictions in the *Investment Trust Study* has previously been noted (p. 19, *supra*). The SEC has spoken out repeatedly since then. In the documents submitted by appel-

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[33] *1973 SEC Hearings*, Comments of the United States Department of Justice, pp. 13-14.

[34] *1973 SEC Hearings* at 2089-2090.

lant as exhibits below (GX. 6; App. p. 251), the SEC staff recognized in a 1959 memorandum regarding an NASD rule, which would have prohibited contract dealers from engaging in a secondary dealer market,

> "that selling group agreements could and often did bar such transactions."

Thus there was official recognition 15 years ago that private agreements could and did impose restrictions on a secondary dealer market, of which the SEC was fully aware.

The SEC has repeatedly broken "silence" regarding the restrictions questioned here, evidencing its complete awareness, yet non-disapproval of them.[35] As late as 1973, in SEC correspondence with a principal underwriter, submitted as an exhibit by the appellant below (GX. 5; App. p. 247), the Chief Counsel of the Division of Investment Management Regulation stated that "the [1940] Act does not prohibit a broker-dealer from acting as an agent with respect to a client," but continued:

> "It is not clear to me whether or not paragraph 3 of your Dealer Agreement prohibits such broker activity, but I assume that, if it does, *you would waive the prohibition.*"

Hence, the SEC not only recognizes that contractual restrictions exist, but acknowledges their propriety, since one can only "waive" an "existing right."[36]

Clearly then, in § 22(f) Congress validated restrictions on the secondary markets existing in 1940 substantially

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[35] *Special Study*, Part 4, p. 98; *In re First Multifund of America, Inc.*, CCH F. Sec. L. Rep. ¶ 78,209 at p. 80602 n (1971); *Matter of Mutual Funds Advisory, Inc.*, Investment Company Act Release No. 6932 at 6, 7 (1972); *1972 Staff Study* at 24.

[36] *Van Bourg* v. *Nitze*, 388 F.2d 557, 565 (D.C. Cir. 1967); accord: *United States* v. *Robinson*, 459 F.2d 1164, 1168, (D.C. Cir. 1972), quoting *Johnson* v. *Zerbst*, 304 U.S. 458, 464 (1938).

identical with those now challenged in 1975 as antitrust violations, provided only that they are disclosed to, and not disapproved by, the SEC.

The 1974 Report makes clear the SEC's purpose to exercise its powers under § 22(f) to disapprove limitations on competition in a secondary brokered market, but to permit their continuance in a secondary dealer market. In view of the existence and exercise of that administrative power, the instant attempt to procure an antitrust injunction presents the imminent danger envisioned by this Court in *Pan American World Airways, Inc., supra,* at 310:

> "If the courts were to intrude independently with their construction of the antitrust laws, two regimes might collide."

B. By Section 22(d) Congress Intended to Protect the Primary Distribution System from Competition in a Secondary Market.

Section 22(d) requires "dealers" to sell mutual fund shares at the "public offering price", including the sales load. Enacted against the background of the bootleg market maintained by dealers undercutting the full sales price, § 22(d) eliminated that price competition by taking away the right of any dealer to undercut the primary distribution system.

Appellant, however, claims that § 22(d) had only the narrow goals of eliminating dilution, insider trading and riskless trading. Yet the broad sweep of the section discountenances this attempt so to limit its scope. As one industry member wrote at the time the Act was under Congressional consideration,

> "The problem of dilution and riskless trading is inherent in the existing pricing methods of selling open-end shares. * * * This practice is aggravated

when the dealers manage to sell back their shares immediately to the company at a profit to themselves, obviously at the expense of the trust and without risk. *There can be no doubt that this represents an unwholesome condition, but Section 22(d) is not needed to eliminate it.* It is already covered by Section 22(a), which is designed to eliminate riskless trading and dilution.

* * *

"If the provision [§ *22(d)*] *will achieve anything at all—and we think it was designed for this purpose —it will effectively hamper street dealers in dealing in trust shares, concentrate such transactions in the hands of authorized dealers and principal underwriters, and thus create a virtual monopoly."* [37]

Numerous pronouncements of the SEC since the passage of the statute support the view that Congress intended § 22(d) to have a broad impact on the price-cutting secondary market.[38] The discussion of § 22(d) before Congress in 1967, when amendment was under consideration, also presented the view that § 22(d) precluded all price competition. Thus SEC Chairman Cohen testified before Congress in 1967:

"Mutual fund sales charges are not free market prices determined by free competition. They are

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[37] "Memorandum covering S. 4108" from Asiel & Co., to the NASD (1940) (App. pp. 314-315). This memorandum was also presented to the SEC.

[38] *Matters of Investors Diversified Service, Inc., et al.*, Investment Company Act Release No. 3015 (April 15, 1960); *Matter of Notice of Proposal to Adopt Rule N-22D-1*, Investment Company Release No. 2718 (May 28, 1958); *Matter of Adoption of Rule N-22D-1*, Investment Company Act Release No. 2798 (December 2, 1958); *Matter of Spiro Sideris, d/b/a Olympic Insurance and Securities Agency*, Securities Exchange Act Release 3816 (February 13, 1970); *Matter of Axe-Houghton Fund, Inc.*, 25 SEC 133, 139 (1947); *Mutual Funds Advisory, supra*, Brief submitted by SEC Division of Corporate Regulation, p. 12; See also, *Greene, op. cit. supra*, at 371.

> fixed under an exemption from the antitrust laws found in Section 22(d) of the Investment Company Act."[39]

And the Antitrust Division of the Justice Department reluctantly agreed:

> "It is true that Congress, in originally enacting the 'fixed price' provisions of Section 22(d) in 1940, provided for the mutual fund industry an exception to the basic competitive requirements of the antitrust laws."[40]

Hence, Congress, in refusing to amend § 22(d) in 1970, acted on the basis that the section effectively precluded price competition. Appellant cites no testimony or other evidence showing that Congress was apprised that any price competition, from a "brokerage market" or otherwise, was permissible under § 22(d). The claim is therefore completely unwarranted that Congress "favors transactions in a secondary market at competitively fixed prices" (Appellant's Brief, p. 40). Section 22(d) was intended to eliminate price competition, not favor it.

Why, then, is it contended in this case that by using the word "dealer" in § 22(d), Congress did not mean to eliminate a *brokerage* market? It is, we believe, because the Department of Justice continues to question the wisdom of the Congressional decision that mutual funds should be free from price competition in a secondary market. In an effort to negate that decision by judicial decree, the Department claims discovery of a "loophole" in the statute, *i.e.*, if "dealer" is defined narrowly, § 22(d) can be so read

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[39] *1967 House Hearings* at 109.

[40] Letter from Deputy Attorney General Warren Christopher to Harley O. Staggers, Chairman, House Committee on Interstate and Foreign Commerce, October 18, 1967, *1967 House Hearings* at 21.

as to permit competition in a secondary brokerage market (Appellant's Brief, pp. 21-22). But one must disregard history to argue that Congress knowingly and intentionally created such an escape hatch in light of its clearly expressed contrary intention to insure the exclusion of this very same price competition. Throughout the legislative and administrative history of the Act, the words "broker", "agent" and "dealer" are used interchangeably in Congressional hearings by witnesses and legislators alike,[41] and the ultimate message from Congress is clear—*all* price competition should be, and is, precluded by § 22(d).

It should be noted that the appellant's interpretations of both §§ 22(d) and 22(f), when taken together, lead to the incongruous conclusion that no section of the 1940 Act had any connection with the bootleg market problem. Yet, it is not disputed that the bootleg market existed in 1940. That it was regarded by the SEC and the industry alike as a danger to the primary distribution system is also indisputable. In the face of these facts, it is incredible that the coauthors of the 1940 Act would nevertheless fail to provide in their proposed legislation any remedy for the problem they both viewed with such concern.

C. Whether the Secondary Markets Sought by the Appellant Would Serve the Public and Industry Interests is a Legislative and Administrative, and Not a Judicial Issue.

Appellant argues that secondary market price competition is not inimical to the maintenance of the primary distribution system (Appellant's Brief, pp. 33-35). Be that

[41] See, *e.g.*, statements of Senator Mondale, *1967 Senate Hearings* at 275, 769 (§ 22(d) acts upon "agents"); testimony of Paul Samuelson, *1967 Senate Hearings* at 348 (§ 22(d) acts upon "brokers"); testimony of SEC Chairman Cohen, *1967 House Hearings* at 711 (§ 22(d) acts upon "broker-dealers").

as it may, it is clear that in 1940 and again in 1967 Congress, the SEC and the industry all proceeded on the assumption that this price competition indeed posed a threat to the primary distribution system. Moreover, whether that system should be altered is peculiarly a matter for administrative and legislative determination.

Years of study and extensive hearings have gone into the completion of the 1974 Report. During this period, the question as to the advisability of introducing price competition into the marketing of mutual fund shares has been given primary and prolonged consideration. The views expressed regarding the question have been many and varied.[42] The final result of these labors is the recommendation of the 1974 Report that limited and experimental competition in the sale of shares in a secondary *brokerage* market warrants some risks to the primary distribution system. Even so, the SEC still adheres to its cautionary approach, stating:

> "steps should be taken to prevent a secondary brokered market from having an adverse impact on the primary distribution system." (p. 109)

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[42] For example, SEC witnesses before Congress have, in the past, seriously questioned the notion of price competition. In testifying on the possible repeal of § 22(d) in 1967, SEC Chairman Cohen stated that

> "It may be a valid argument that to introduce a competitive regime in this industry would be to break too sharply with its established ways of doing business." (*1967 House Hearings* at 113.)

And in 1969, SEC Commissioner Owens told the Senate Committee on Banking & Currency that

> "We don't know what condition will result in the market place if 22(d) is repealed.
>
> "We are told that wildcatting and price cutting will be ruinous to the industry. It well might be." (*1969 Senate Hearings* at 24-5.)

However, as to retail price competition in both the primary and secondary brokerage dealer markets, the Report concludes:

> "We believe that mutual fund shares could not be sold effectively under a system of full retail price competition in the present distribution environment; nor is it likely that the public would significantly benefit from an attempt to institute such a system without an appropriate foundation having first been laid for it." (p. 80)

The 1974 Report recommends a panoply of administrative and legislative action for the tentative and gradual introduction of price competition into the alien field of mutual fund marketing. It would be unwarranted and unwise indeed to permit the present antitrust litigation to intrude upon and disrupt the administrative and legislative process now in progress.

D. The First Count of the Complaint Alleging Improper "Collusive Action" was Properly Dismissed.

The decision below dismissed claims of two different alleged restraints—vertical restraints by the various fund, underwriter and dealer appellees (Counts II-VII of the Complaint) and alleged horizontal "collusive action" restraints by the NASD and all the other appellees (Complaint, Count I). The appellant urges that, even assuming the counts alleging vertical restraints were properly dismissed, the allegations of collusive horizontal action must stand (Appellant's Brief, p. 63).

In this connection, appellant's assertion that the motion below could not be granted unless immunity could be found "for virtually any set of facts relating to suppression of competition in secondary markets that the government might prove" (Appellant's Brief, p. 18) ignores both the

language of the Complaint and the nature of the proceedings below.

It is admitted that "appellees appended exhibits to their supporting memoranda [43] and the government filed an affidavit describing certain attached documents *in support of the allegations in its complaint.*" Admittedly, these affidavits and documentary exhibits were accepted without objection by the lower court (Appellant's Brief, p. 16, n. 14).

FRCP 12(b)(6), under which the dismissal motions originated, provides that if on a motion to dismiss under subdivision (6), "matters outside the pleading are presented to and not excluded by the court, the motion *shall* be treated as one for summary judgment and disposed of as provided in Rule 56." Hence the motions to dismiss the complaint below *required* treatment as motions for summary judgment. But "the very mission of the summary judgment procedure is to pierce the pleadings and to assess the proof in order to see whether there is a genuine need for trial." [44]

Moreover, on a motion for summary judgment, "an adverse party may not rest upon the mere allegations or denials of his pleading, but his response, by affidavits or as otherwise provided in this rule, must set forth specific facts showing that there is a genuine issue for trial. If he does not so respond, summary judgment, if appropriate, shall be entered against him." FRCP Rule 56(e)

Appellant, as the record shows, recognized and attempted to meet this burden by filing Mr. Hunter's affida-

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[43] Actually, Fidelity filed an affidavit by its Secretary, Caleb Loring, with attached evidentiary exhibits showing Fidelity's compliance with the filing requirements of § 22(f). (App. pp. 155-56)

[44] 1963 Advisory Committee Note to FRCP Rule 56(e).

vit [45] and annexing thereto some thirty exhibits in support of the Complaint, including the allegations of collusive activity on the part of the appellees (Hunter Affidavit and Exhibits, App. pp. 230-305). Appellees did not deny the authenticity of these exhibits, but rather relied on their content as evidence conclusively showing the absence of any issue of fact as to the alleged conspiracy.

Thus in evaluating the charges of "collusive action", the proper inquiry is not into "any set of facts" imaginable that the appellant might prove, but rather into the sufficiency of the specific allegations of the Complaint, as amplified by the supporting Hunter Affidavit and documentary exhibits. Neither the allegations nor the exhibits can withstand such analysis.

The collusive action charged is detailed in Paragraph 17 of the Complaint. Subparagraphs 17(a) and (b) allege that the NASD has "established and maintained rules" restricting a secondary market. (App. p. 9) However, since appellant has now disclaimed attacking NASD rules (Appellant's Brief, p. 51), these allegations have become moot. Subparagraph 17(c) alleges that the NASD has "induced member principal underwriters to include restrictive provisions in their sales agreements." To buttress this allegation, the appellant submitted documents (GX 6; App. p. 253) referring to a 1959 proposal to amend NASD rules to preclude certain secondary market dealer activity. In its discussion of this incident in its brief, the appellant argues that the documents show the SEC opposed such a rule as not supported by the 1940 Act (Appellant's Brief, p. 61). But the appellant omits the fact, shown by the very same documents, that the SEC staff,

[45] The Hunter Affidavit clearly does more than merely identify documents (Appellant's Brief, p. 14n), but argues the appellant's position and was intended to support the Complaint's allegations. See, *e.g.*, pars. 8 and 9, App. p. 231.

in consultation with the NASD, suggested that the dealer agreements could be so written as to accomplish the same goal. The NASD circulated this staff suggestion among its members, including the appellees. Thus the appellant's own documentary evidence disproves its allegations of "collusive" action, since such action, if taken, merely followed the suggestion of the SEC itself. There is no statement or even intimation by the appellant that it possesses any additional facts to support the allegations of Paragraph 17(c) other than this 1959 incident.

Finally, subparagraphs 17(d) and (e) allege in vague terms that the appellees disseminated misleading marketing information and suppressed quotations of market prices. (App. p. 9) Appellant did not attempt to support or even specify these charges by concrete facts, documents or affidavit. In any event, the publication of market quotations and the dissemination of other market information is under the constant and close supervision of both the NASD and SEC, as the Court may judicially notice, and falls under the regulatory authority and control of these bodies. See, *e.g.*, *§ 15(c)(2), Securities Exchange Act of 1934.*

Appellant assumes arguendo that vertical restrictions on the distribution of a fund's shares may be permitted by the SEC under § 22(f), but contends that "a horizontal conspiracy" among the appellees "to impose restrictive provisions" would be illegal, citing *Georgia* v. *Pennsylvania R. Co.*, 324 U.S. 439 (1945). That case is inapposite. It held that a conspiracy among railroads to fix discriminatory and coercive rates in violation of the antitrust laws may be enjoined even though the rates themselves have not yet been passed upon by the Interstate Commerce Commission. Indeed it was intimated that an injunction against a rate-fixing conspiracy might issue at the instance of the United States even after the rates have received Commission ap-

proval. That is to say, while the Interstate Commerce Commision had jurisdiction to determine that the rates were reasonable in amount, it was without power to deal with the alleged private antitrust conspiracy fixing those rates. As Justice Douglas wrote for the majority of five:

> ". . . Congress has not given the Commission comparable authority to remove rate-fixing combinations from the prohibitions contained in the antitrust laws. It has not placed these combinations under the control and supervision of the Commission. Nor has it empowered the Commission to proceed against such combinations through cease and desist orders, or otherwise to put an end to their activities." (p. 456)

This certainly cannot be said of the SEC's authority under the 1940 Act. It has the power to enforce the mandatory price-maintenance provisions of § 22(d), and to grant exemptions from that section (§ 6(c)); and it may promulgate rules and regulations to make any provisions of the Act more effective in the public interest (§ 38). Under § 22(f), as we have seen, it may in its discretion permit or prohibit or modify restrictions on the transferability and negotiability of shares—classic antitrust restraints on trade. In addition, the NASD, which is itself immunized from the antitrust laws under the Maloney Act, is empowered to insure the reasonableness of the sales loads charged to investors (§ 22(b)).

Georgia v. *Pennsylvania R. Co.* therefore is not authority for the application of the Sherman Act to the "horizontal" conspiracy here alleged, just as it is impossible to find the existence of such a conspiracy under the facts alleged and the documents submitted to support the instant Complaint.

E. The Practices Challenged Here are Immunized From Antitrust Attack by the Pervasive Regulatory Power of the SEC.

That the powers of the SEC in the premises are pervasive can hardly be denied. The appellant, however, erroneously contends that a mere grant of pervasive regulatory power without specific antitrust exemption is not sufficient to immunize regulated conduct from antitrust liability (Appellant's Brief, p. 56). This view, however, is contrary to the pronouncements of this Court. See, *e.g., Pan American World Airways, Inc., supra*; *Hughes Tool Co.* v. *Trans World Airlines, supra*; *Silver* v. *New York Stock Exchange*, 373 U.S. 341 (1963); *United States* v. *Philadelphia National Bank*, 374 U.S. 321 (1963). The test, as declared in the *Philadelphia National Bank* case, is whether the regulatory scheme "is so comprehensive that enforcement of the antitrust laws would either be unnecessary, in light of the completeness of the regulatory structure, or disruptive of that structure." (p. 352) In this case the regulatory structure is complete, and the inevitable interference with that structure by an antitrust decree would clearly be disruptive.

Appellant contends further that in order to find antitrust immunity:

> "(1) the conduct challenged in the antitrust action must be the precise subject of a proceeding subject to the regulatory agency's remedial powers; (2) the regulatory scheme must require the supervising agency to focus upon competitive considerations in exercising those powers; and (3) the agency must have express statutory authority to immunize the conduct in question from the antitrust laws." (Appellant's Brief, p. 56)

The first of the appellant's tests is clearly met in this case; the other two are not required for limited antitrust immunity.

First. The alleged inhibitions upon competition in a secondary market which are challenged here "are the precise subject of a proceeding subject to the regulatory agency's remedial powers" long exercised and culminating in the 1974 Report.

Second. It is not necessary, as the appellant contends, that the regulatory scheme require competitive considerations to be taken into account by the supervising agency. But even if it were, it cannot be said that the SEC is not required to consider competitive criteria when the price-fixing mandated by § 22(d), the reasonableness of the sales load and the propriety of restraints on the transferability of shares, all necessarily involve competitive considerations in the exercise of the SEC's powers.

Third. The SEC does in fact have "express statutory authority to immunize" the restrictions in question from the antitrust laws under § 22(f). Even assuming those restrictions would otherwise be violations of the Sherman Act, the SEC may immunize them from the antitrust laws by its decision not to adopt any contravening rule or regulation.

In any event, the SEC is expressly required by the Maloney Act to take competition into account when reviewing NASD rules. 15 U.S.C. § 78o-3(b)(8) The 1940 Act itself is intended to promote the "public interest"[46] and it is this mandate which controls the SEC's regulatory action regarding competitive factors in the industry.

[46] 1940 Act, § 1. In addition, by Section 22(f) the SEC is required to regulate transferability restrictions "in the interests of the holders" of a fund's shares. See, also, §§ 6(c), 38.

As this Court stated in the *Pan American* case, *supra*:

> "It would be strange, indeed, if a division of territories or an allocation of routes which met the requirements of the 'public interest' as defined in § 2 [of the Federal Aviation Act] were held to be antitrust violations." (p. 309)

So here, it would be "strange, indeed" if anticompetitive restrictions, monitored and not disapproved by the SEC in the "public interest", were held to be violative of the antitrust laws.

In *Pan American, supra,* the Court held that Pan American was immunized from the antitrust laws for acts taken subject to the approval of the Civil Aeronautics Board under § 411 of the Federal Aviation Act. Even though other sections of that statute granted express antitrust immunity and despite the absence of such exemptive language in § 411, the Court nevertheless found the pervasive powers of the Civil Aeronautics Board over the challenged conduct were sufficient for immunity from the antitrust laws.

This view was well expressed in another connection in the recent case of *Gordon* v. *New York Stock Exchange,* 498 F.2d 1303 (2d Cir. 1974), *certiorari granted,* —— U.S. ——; 42 L.Ed. 2d 291. There immunity from the antitrust laws was found for the fixing of stock exchange brokerage commission rates in view of the SEC's broad regulatory powers over them. The court held that the regulatory aims promoted by Congress in delegating power to the SEC over the commission rate structure would be frustrated by "inconsistent standards announced contemporaneously by courts and Commission." (p. 1306) Here, appellant seeks precisely this contemporaneous misapplication of "inconsistent standards."

Conclusion

All phases of mutual fund marketing, especially the competitive aspect of sales of shares to the public, are and have continually been closely scrutinized and regulated by the SEC and the NASD under the 1940 Act. They have been the constant object of Congressional concern as well. Therefore, activities in this area may not be made the recipients of dispensations under the 1940 Act, as administered by the SEC, and at the same time be subjected to the interdictions of the Sherman Act, as misapplied by the Department of Justice in the case at bar.

The Judgment of the District Court Should be Affirmed.

Respectfully submitted,

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